Exhibit 21

HEDGE
MAR
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Madoff tops charts; skeptics ask how

By Michael Ocrant

Mention Bernard L. Madoff Investment Securities to anyone working on Wall Street at any time over the last 40 years and you're likely to get a look of immediate recognition.

After all, Madoff Securities, with its 600 major brokerage clients, is ranked as one of the top three market makers in Nasdaq stocks, cites itself as probably the largest source of order flow for New York Stock Exchange-listed securities, and remains a huge player in the trading of preferred, convertible and other specialized securities instruments.

Beyond that, Madoff operates one of the most successful "third markets" for trading equities after regular exchange hours, and is an active market maker in the European and Asian equity markets. And with a group of partners, it is leading an effort and developing the technology for a new electronic auction market trading system called Primex.

But it's a safe bet that relatively few Wall Street professionals are aware that Madoff Securities could be categorized as perhaps the best risk-adjusted hedge fund portfolio manager for the last dozen years. Its $6–7 billion in assets under management, provided primarily by three feeder funds, currently would put it in the number one or two spot in the Zurich (formerly MAR) database of more than 1,100 hedge funds, and would place it at or near the top of any well-known database in existence defined by assets.

More important, perhaps, most of those who are aware of Madoff's status in the hedge fund world are baffled by the way the firm has obtained such consistent, nonvolatile returns month after month and year after year.

Madoff has reported positive returns for the last 11-plus years in assets managed on behalf of the feeder fund known as Fairfield Sentry, which in providing capital for the program since 1989 has been doing it longer than any of the other feeder funds. Those other funds have demonstrated equally positive track records using the same strategy for much of that period.

Lack of volatility

Those who question the consistency of the returns, though not necessarily the ability to generate the gross and net returns reported, include current and former traders, 16▶

HEDGE UPDATE

Michael Berger catches a jail break

New chapters have been written in the continuing saga of **Michael Berger's Manhattan Investment Fund**, with the admitted fraudster's apparently inevitable jail term deferred when his counsel quit. Meanwhile, the civil cases against the 'deep pockets' associated with Berger—his prime broker **Bear, Stearns**, his auditor **Deloitte** 2▶

Did you know that Bernie Madoff may be the best risk-adjusted hedge fund portfolio manager?
Cover

Read one European pension fund investor's comments about its foray into hedge funds.
Page 13

Last year there was a huge spread between the winners and losers in the technology sector. What did the winners do right?
Page 14

◄1 other money managers, consultants, quantitative analysts and fund-of-funds executives, many of whom are familiar with the so-called split-strike conversion strategy used to manage the assets.

These individuals, more than a dozen in all, offered their views, speculation and opinions on the condition that they wouldn't be identified. They noted that others who use or have used the strategy—described as buying a basket of stocks closely correlated to an index, while concurrently selling out-of-the-money call options on the index and buying out-of-the-money put options on the index—are known to have had nowhere near the same degree of success.

The strategy is generally described as putting on a "collar" in an attempt to limit gains compared to the benchmark index in an up market and, likewise, limit losses to something less than the benchmark in a down market, essentially creating a floor and a ceiling.

Madoff's strategy is designed around multiple stock baskets made up of 30-35 stocks most correlated to the S&P 100 index. In marketing material issued by Fairfield Sentry, the sale of the calls is described as increasing "the standstill rate of return, while allowing upward movement of the stock portfolio to the strike price of the calls." The puts, according to the same material, are "funded in large part by the sale of the calls, [and] limit the portfolio's downside.

"A bullish or bearish bias can be achieved by adjusting the strike prices of the options, overweighting the puts, or underweighting the calls. However, the underlying value of the S&P 100 puts is always approximately equal to that of the portfolio of stocks," the marketing document concludes.

Throughout the entire period Madoff has managed the assets, the strategy, which claims to use OTC options almost entirely, has appeared to work with remarkable results.

Again, take the Fairfield Sentry fund as the example. It has reported losses of no more than 55 basis points in just four of the past 139 consecutive months, while generating highly consistent gross returns of slightly more than 1.5% a month and net annual returns roughly in the range of 15.0%.

> "This has been a good period to do this kind of stuff"

Among all the funds on the database in that same period, the Madoff/Fairfield Sentry fund would place at number 16 if ranked by its absolute cumulative returns.

Among 423 funds reporting returns over the last five years, most with less money and shorter track records, Fairfield Sentry would be ranked at 240 on an absolute return basis and come in number 10 if measured by risk-adjusted return as defined by its Sharpe ratio.

What is striking to most observers is not so much the annual returns—which, though considered somewhat high for the strategy, could be attributed to the firm's market making and trade execution capabilities—but the ability to provide such smooth returns with so little volatility.

The best known entity using a similar strategy, a publicly traded mutual fund dating from 1978 called Gateway, has experienced far greater volatility and lower returns during the same period.

The capital overseen by Madoff through Fairfield Sentry has a cumulative compound net return of 397.5%. Compared with the 41 funds in the Zurich database that reported for the same historical period, from July 1989 to February 2001, it would rank as the best performing fund for the period on a risk-adjusted basis, with a Sharpe ratio of 3.4 and a standard deviation of 3.0%. (Ranked strictly by standard deviation, the Fairfield Sentry funds would come in at number three, behind two other market neutral funds.)

Questions abound

Bernard Madoff, the principal and founder of the firm who is widely known as Bernie, is quick to note that one reason so few might recognize Madoff Securities as a hedge fund manager is because the firm makes no claim to being one.

The acknowledged Madoff feeder funds—New York-based Fairfield Sentry and Tremont Advisors' Broad Market; Kingate, operated by FIM of London; and Swiss-based Thema—derive all the incentive fees generated by the program's returns (there are no management fees), provide all the administration and marketing for them, raise the capital and deal with investors, says Madoff.

Madoff Securities' role, he says, is to provide the investment strategy and execute the trades, for which it generates commission revenue.

[Madoff Securities also manages money in the program allocated by an unknown number of endowments, wealthy individuals and family offices. While Bernie Madoff refuses to reveal total assets under management, he does not dispute that the figure is in the range of $6 billion to $7 billion.]

Madoff compares the firm's role to a private managed account at a broker-dealer, with the broker-dealer providing investment ideas or strategies and executing the trades and making money off the account by charging commission on each trade.

Skeptics who express a mixture of amazement, fascination and curiosity about the program wonder, first, about the relative complete lack of volatility in the reported monthly returns.

But among other things, they also marvel at the seemingly astonishing ability to time the market and move to cash in the underlying securities before market conditions turn negative; and the related ability to buy and sell the underlying stocks without noticeably affecting the market.

In addition, experts ask why no one has been able to duplicate similar returns using the strategy and why other firms on Wall Street haven't become aware of the fund and its strategy and traded against it, as has happened so often in other cases; why Madoff Securities is willing to earn commissions off the trades but not set up a separate asset management division to offer hedge funds directly to investors and keep all the incentive fees for itself, or conversely, why it doesn't borrow the money from creditors, who are generally willing to provide leverage to a fully hedged portfolio of up

to seven to one against capital at an interest rate of Libor-plus, and manage the funds on a proprietary basis.

These same skeptics speculate that at least part of the returns must come from other activities related to Madoff's market making. They suggest, for example, that the bid-ask spreads earned through those activities may at times be used to "subsidize" the funds.

According to this view, the benefit to Madoff Securities is that the capital provided by the funds could be used by the firm as "pseudo equity," allowing it either to use a great deal of leverage without taking on debt, or simply to conduct far more market making by purchasing additional order flow than it would otherwise be able to do.

And even among the four or five professionals who express both an understanding of the strategy and have little trouble accepting the reported returns it has generated, a majority still expresses the belief that, if nothing else, Madoff must be using other stocks and options rather than only those in the S&P 100.

Bernie Madoff is willing to answer each of those inquiries, even if he refuses to provide details about the trading strategy he considers proprietary information.

And in a face-to-face interview and several telephone interviews, Madoff sounds and appears genuinely amused by the interest and attention aimed at an asset management strategy designed to generate conservative, low risk returns that he notes are nowhere near the top results of well-known fund managers on an absolute return basis.

Lack of volatility illusory

The apparent lack of volatility in the performance of the fund, Madoff says, is an illusion based on a review of the monthly and annual returns. On an intraday, intraweek and intramonth basis, he says, "the volatility is all over the place," with the fund down by as much as 1%.

But as whole, the split-strike conversion strategy is designed to work best in bull markets and, Madoff points out, until recently "we've really been in a bull market since '82, so this has been a good period to do this kind of stuff."

Market volatility, moreover, is the strategy's friend, says Madoff, as one of the fundamental ideas is to exercise the calls when the market spikes, which with the right stock picks would add to the performance.

In the current bearish environment, when some market experts think the fund should have been showing negative returns, albeit at levels below the benchmark index, managing the strategy has become more difficult, says Madoff, although performance has remained positive or, as in February, flat.

The worst market to operate in using the strategy, he adds, would be a protracted bear market or "a flat, dull market." In a stock market environment similar to what was experienced in the 1970s, for instance, the strategy would be lucky to return "T-bill like returns."

Market timing and stock picking are both important for the strategy to work, and to those who express aston- 18►

◄17 ishment at the firm's ability in those areas, Madoff points to long experience, excellent technology that provides superb and low-cost execution capabilities, good proprietary stock and options pricing models, well-established infrastructure, market making ability and market intelligence derived from the massive amount of order flow it handles each day.

The strategy and trading, he says, are done mostly by signals from a proprietary "black box" system that allows for human intervention to take into account the "gut feel" of the firm's professionals. "I don't want to get on an airplane without a pilot in the seat," says Madoff. "I only trust the autopilot so much."

As for the specifics of how the firm manages risk and limits the market impact of moving so much capital in and out of positions, Madoff responds first by saying, "I'm not interested in educating the world on our strategy, and I won't get into the nuances of how we manage risk." He reiterates the undisputed strengths and advantages the firm's operations provide that make it possible.

Multiple stock baskets

Avoiding market impact by trading the underlying securities, he says, is one of the strategy's primary goals. This is done by creating a variety of stock baskets, sometimes as many as a dozen, with different weightings that allow positions to be taken or unwound slowly over a one- or two-week period.

Madoff says the baskets comprise the most highly capitalized liquid securities in the market, making the entry and exit strategies easier to manage.

He also stresses that the assets used for the strategy are often invested in Treasury securities as the firm waits for specific market opportunities. He won't reveal how much capital is required to be deployed at any given time to maintain the strategy's return characteristics, but does say that "the goal is to be 100% invested."

The inability of other firms to duplicate his firm's success with the strategy, says Madoff, is attributable, again, to its highly regarded operational infrastructure. He notes that one could make the same observation about many businesses, including market making firms.

Many major Wall Street broker-dealers, he observes, previously attempted to replicate established market making operations but gave up trying when they realized how difficult it was to do so successfully, opting instead to acquire them for hefty sums.

> "The strategy is the strategy and the returns are the returns"

[Indeed, says Madoff, the firm itself has received numerous buyout offers but has so far refused any entreaties because he and the many members of his immediate and extended family who work there continue to enjoy what they do and the independence it allows and have no desire to work for someone else.]

Similarly, he adds, another firm could duplicate the strategy in an attempt to get similar results, but its returns would likely be unmatched because "you need the physical plant and a large operation" to do it with equal success. However, many Wall Street firms, he says, do use the strategy in their proprietary trading activities, but they don't devote more capital to such operations because their return on capital is better used in other operations.

Setting up a proprietary trading operation strictly for the strategy, or a separate asset management division in order to collect the incentive fees, says Madoff, would conflict with his firm's primary business of market making.

Commissions suffice

"We're perfectly happy making the commissions" by trading for the funds, he says, which industry observers note also gives the firm the entirely legitimate opportunity to "piggyback" with proprietary trading that is given an advantage by knowing when and where orders are being placed.

Setting up a division to offer funds directly, says Madoff, is not an attractive proposition simply because he and the firm have no desire to get involved in the administration and marketing required for the effort, nor to deal with investors.

Many parts of the firm's operations could be similarly leveraged, he notes, but the firm generally believes in concentrating on its core strengths and not overextending itself. Overseeing the capital provided by the funds and its managed accounts, he says, provides another fairly stable stream of revenue that offers some degree of operational diversification.

Madoff readily dismisses speculation concerning the use of the capital as "pseudo equity" to support the firm's market making activities or provide leverage. He says the firm uses no leverage, and has more than enough capital to support its operations.

He notes that Madoff Securities has virtually no debt and at any given time no more than a few hundred million dollars of inventory.

Since the firm makes markets in only the most highly capitalized, liquid stocks generally represented by the S&P 500 index, a majority of which are listed on the NYSE, as well as the 200 most highly capitalized Nasdaq-listed stocks, says Madoff, it has almost no inventory risk.

Finally, Madoff calls ridiculous the conjecture that the firm at times provides subsidies generated by its market making activities to smooth out the returns of the funds in a symbiotic relationship related to its use of the capital as a debt or equity substitute. He agrees that the firm could easily borrow the money itself at a fairly low interest rate if it were needed, and would therefore have no reason to share its profits. "Why would we do that?"

Still, when the many expert skeptics were asked by MAR/Hedge to respond to the explanations about the funds, the strategy and the consistently low volatility returns, most continued to express bewilderment and indicated they were still grappling to understand how such results have been achieved for so long.

Madoff, who believes that he deserves "some credibility as a trader for 40 years," says: "The strategy is the strategy and the returns are the returns." He suggests that those who believe there is something more to it and are seeking an answer beyond that are wasting their time. ■

Exhibit 22

JUN 8 1999

3 Firms Plan To Develop New System For Trading

In a deal indicating that even the largest Wall Street firms are unsure how or where stocks will be traded in the not so distant future, **Goldman Sachs Group Inc.** and **Merrill Lynch & Company** announced yesterday that they had joined with **Bernard L. Madoff Investment Securities**, a large stock trading firm, to form Primex Trading N.A., an alternative stock trading system.

The company will offer electronic access to investors interested in trading stocks listed on the New York Stock Exchange, the American Stock Exchange and Nasdaq. Primex is expected to begin operations a year from now, at roughly the same time stocks begin being priced in decimals rather than fractions.

"What we are hoping to do is create an electronic extension of a pure auction securities market trading on a physical floor by expanding participation to a broad-based electronic crowd," said Peter Madoff, a senior managing director at Madoff Investment Securities. In an auction market, like the Big Board, all orders for a particular stock are handled by one trader, known as a specialist, who must execute the trades as well as maintain a fair and orderly market in the shares. A dealer market, like Nasdaq, has multiple traders, known as market makers, executing customer orders in many places.

Spokesmen for Primex said it would differ from other alternative systems, known as electronic communications networks, or E.C.N.'s, because Primex would be more than just a place for investors to meet to execute trades at prices they have specified. Rather it will allow investors to receive prices on their trades that are superior to the current best bid or offer made by specialists or market makers. Primex will do this by guaranteeing that its customers get the best current price for their trades while allowing them to state how much more they would ideally like to receive for the stock they are selling or how much less they would like to pay if they could. If another Primex customer were willing to pay more for the trade or sell the stock for less, the client initiating the trade would benefit.

Primex will be accessible to brokerage firms, institutional investors, market makers and exchange specialists. The entry of orders will be anonymous; the cost of participation in the system has not yet been disclosed. But if the system attracts a sizable clientele, it will be likely to reduce the difference between the bid and asked prices on stocks, known as the spread.

"There's an element of uncertainty in the marketplace," said Jonathan Humphreys, a Merrill Lynch spokesman. "And we're looking at those innovations that we believe can achieve a critical mass and will position us better to serve our clients."

Terms of the deal were not disclosed.

Exhibit 23

SEP 14 1999

4 Leading Securities Firms Join Forces to Back Primex

Electronic System Offers Stock Bargaining

By JOSEPH KAHN

The four largest securities firms in the United States have joined forces to back **Primex Trading**, a novel electronic auction system for stocks, giving Primex a jump-start in the static-filled world of electronic trading.

Citigroup's Salomon Smith Barney and **Morgan Stanley Dean Witter** yesterday said that they had joined three earlier backers, **Goldman, Sachs & Company**, **Merrill Lynch & Company** and **Bernard L. Madoff Investment Securities**, as Primex's partners. Although several other new electronic trading networks have attracted investments from multiple banks and securities firms, support from the four leading Wall Street firms seems likely to secure Primex a substantial flow of trading orders from the moment it begins, probably next summer.

Primex is aiming to be an electronic version of the New York Stock Exchange. Participants will not only be able to buy and sell stocks at prevailing market prices, as they now do through many traditional and electronic exchanges, but also interact openly with one another — in effect, bargain — to find the best prices possible.

"I think the fact four of the world's largest securities firms have backed this system suggests that it brings something new and unique to our ability to obtain the best execution for our customers," said Bill Hart, a managing director in equity trading at Salomon Smith Barney.

Although the major Wall Street firms are key backers of the New York Stock Exchange and Nasdaq, they have also taken stakes in a variety of new electronic trading networks that compete with traditional exchanges. Electronic networks have already stolen some of the business of matching buy and sell orders for stocks away from exchanges and the securities firms themselves. Exactly how electronic trading will eventually effect the marketplace is uncertain, and nearly all the players seem to be hedging their bets by investing in multiple alternatives.

Peter B. Madoff, the manager and one of the founders of Primex, said the system differs from other trading networks in that it is open and interactive. In other words, it is intended to be a super exchange, giving users the ability to haggle for the best prices with other users on any other trading system. The idea is a good one, some analysts say, but the test will be whether it catches fire with investors.

"Our ability to bring these five parties together is a significant statement," Mr. Madoff said. "They account for a significant portion of stock trading worldwide, and they share the same vision to create a new (stock trading) mechanism."

Mr. Madoff said that Primex would welcome participation by the New York Stock Exchange, which specializes in auction trading the old fashioned way, by open outcry. But there's little doubt that Primex will also compete with the stock exchange.

People involved with Primex said that the participating Wall Street firms are likely to steer many stock transactions through Primex first. For a small fee, Primex would then shop for the best prices available on all other participating exchanges, electronic networks or private broker-dealers. If floor traders on the New York Stock Exchange turn out to be offering the best price, the order will end up there, but could otherwise be settled without ever crossing the exchange floor.

"We having nothing to lose by going to Primex first," said an executive of a securities firm that has invested in Primex and who declined to be identified by name. "That's not really the case with some other electronic networks, because they will not be as broad."

The firms involved with Primex declined to disclose details about the electronic network's ownership structure or the amounts of money they have invested. But one person involved said the four big Wall Street firms had equal stakes in the new venture, which was the brainchild of Peter and Bernard Madoff, two brothers who have been on the cutting edge of Wall Street stock trading for years.

Start-up costs for electronic exchanges are not necessarily formidable. Merrill Lynch last week became the latest securities firm, after E*Trade, Goldman and J. P. Morgan, to buy a stake in Archipelago, one of the best financed of the new electronic networks. It paid about $30 million for a 14.3 percent stake, people close to the firm said.

Exhibit 24

The Washington Post

Madoff Case 'Failures' Put SEC in Spotlight

Agency Looked for, Didn't Find Fraud

By Binyamin Appelbaum
Washington Post Staff Writer
Friday, December 19, 2008

An investigation of Bernard L. Madoff's company by the Securities and Exchange Commission that ended without finding evidence of fraud is emerging as a defining failure for an agency struggling to defend its reputation.

Investigators from the SEC's New York office set out in January 2006 with a list of questions including, specifically, whether Madoff was running a Ponzi scheme. They concluded in November 2007 that there was no evidence of fraud.

Last week, Madoff confessed that his company was "one big lie," according to a complaint filed by SEC officials. Madoff told investigators that he had taken $50 billion from clients -- perhaps the largest Ponzi scheme in history.

The SEC's inability to catch Madoff is the subject of an internal investigation announced this week by Chairman Christopher Cox, who criticized his staff for "apparent multiple failures." Experts on securities fraud, including a number of former SEC employees, said the most troubling of those failures is that investigators went looking for fraud yet did not find it.

"Finding a Ponzi scheme is easy if you know that that's what you're looking for," said one former SEC enforcement official, who spoke on condition of anonymity because he still has dealings with the agency.

The experts cautioned that much remains unclear about the history of the SEC's interactions with Madoff, including the 2006-07 investigation. Without a full picture, they said, it is impossible to determine what mistakes may have been made by SEC staff.

Some also criticized Cox for passing judgment before the investigation was complete and for failing to accept a measure of responsibility.

"I am outraged that Chairman Cox immediately points the finger at front-line employees, even before he begins the internal investigation," said Colleen M. Kelley, president of the National Treasury Employees Union, which represents SEC employees. "The hardworking, dedicated front-line employees at the SEC have been outgunned, underfunded and have suffered from inadequate leadership that is ambivalent about the agency's mission."

Yesterday an agency spokesman declined to comment, citing the ongoing investigation.

Madoff attracted investors by promising steady returns with almost no risk of losses. He quoted a long-term average return of 1 percent a month and 12 percent a year, according to materials distributed to his clients.

It was a spectacular and improbable track record. Measured by a Wall Street ratio that compares risk and reward to evaluate hedge funds, investing with Madoff was more than a sixfold improvement over simply investing in the broad-based Standard & Poor's 500-stock index.

Michael S. Meade, chief executive of Lampost Financial Group, a brokerage and hedge-fund manager, said one client who had invested with Madoff asked him for an evaluation. He investigated, then cautioned the client, saying the results were implausible. The investor remained with Madoff.

"This guy had pheromones for middle-age, well-to-do people," Meade said. "They were attracted to the guy and just threw all caution to the wind if given the opportunity to invest with him."

Analysts and journalists had raised questions about Madoff's performance since at least 1999.

The SEC's decision to investigate Madoff was prompted by the repeated complaints of Harry Markopolos, a Boston investment professional who concluded in 1999, while working for a competitor, that Madoff's apparent success could not be legitimate.

Markopolos said he tried for six years before persuading the SEC to investigate. In November 2005, he sent the agency's New York office a 17-page statement titled "The World's Largest Hedge Fund Is a Fraud." The document was obtained and published by the Wall Street Journal.

Markopolos detailed 29 overlapping reasons that led him to conclude that it was "highly likely" that "Madoff Securities is the world's largest Ponzi Scheme." He presented mathematical evidence that the trading strategy Madoff described could not produce the returns he claimed. He noted that Madoff's purported trading had left no footprints in the marketplace. Most of all, he argued that the details of Madoff's business model -- the structure, the strategy, the secrecy -- made sense only as an elaborate lie concealing a massive fraud.

The argument made a limited impression on SEC officials, who noted in an internal memo that they were opening an investigation but only "because of the substantial amounts at issue . . . in an abundance of caution."

The resulting investigation took almost two years but "found no evidence of fraud," a second memo said.

A person familiar with the matter confirmed the authenticity of the memos, which were published by the Wall Street Journal.

The SEC investigation ruled out the possibility that Madoff was making money for his investors through illegal insider trading. The next step, according to several experts on fraud investigations, was to rule out a Ponzi scheme by verifying the existence of the assets reported by the firm. The operator of a Ponzi scheme pays returns to investors with money received from other investors.

Investigators attempted this reality check by reviewing records provided by Madoff and from hedge funds that funneled money to Madoff.

But the investigation relied entirely on documents provided voluntarily by the companies, the SEC said. Staff members decided not to request the power to subpoena records, which requires the approval of the SEC's commissioners. And the SEC now says that Madoff provided investigators with falsified records and that he concealed from investigators the extent of the investment pool entrusted to his firm.

Another former SEC official who has investigated Ponzi schemes said that perpetrators generally present false records.

"You ought to be able to figure that out," he said, speaking on condition of anonymity to preserve relationships.

It is not clear why investigators accepted Madoff's answers to Markopolos's questions. Madoff was a Wall Street legend, an acquaintance of senior regulators and a major political contributor, mostly to Democrats. The SEC is investigating whether relationships between Madoff's family and regulators played a role.

One simple possibility is suggested by Madoff's long career: He was a very successful salesman.

Michael Ocrant, then a reporter for the trade publication MAR/Hedge, spent hours interviewing Madoff in 2001 for a story that laid out reasons to suspect his success. Extensive reporting had convinced Ocrant that fraud was the likely explanation. Madoff nearly changed his mind.

"What I remember more than anything is that by the time I left, feeling that maybe all these guys who are saying this is a Ponzi scheme or front-running are wrong. Maybe Bernie has really figured out a great trading system," Ocrant recalled. "Because that's how cool and calm and responsive he was."

Staff writer David S. Hilzenrath contributed to this report.

View all comments that have been posted about this article.

Exhibit 25

J. Ezra Merkin

From: BALSAM, JERRY
Sent: Sunday, May 06, 2001 10:14 AM
To: J. Ezra Merkin
Subject: Madoff

http://interactive.wsj.com/articles/SB989019667829349012.htm

Barron's Features

Don't Ask, Don't Tell

Bernie Madoff is so secretive, he even asks investors to keep mum

By ERIN E. ARVEDLUND

Two years ago, at a hedge-fund conference in New York, attendees were asked to name some of their favorite and most-respected hedge-fund managers. Neither George Soros nor Julian Robertson merited a single mention. But one manager received lavish praise: Bernard Madoff.

Folks on Wall Street know Bernie Madoff well. His brokerage firm, Madoff Securities, helped kick-start the Nasdaq Stock Market in the early 1970s and is now one of the top three market makers in Nasdaq stocks. Madoff Securities is also the third-largest firm matching buyers and sellers of New York Stock Exchange-listed securities. Charles Schwab, Fidelity Investments and a slew of discount brokerages all send trades through Madoff.

But what few on the Street know is that Bernie Madoff also manages $6 billion-to-$7 billion for wealthy individuals. That's enough to rank Madoff's operation among the world's three largest hedge funds, according to a May 2001 report in MAR Hedge, a trade publication.

What's more, these private accounts, have produced compound average annual returns of 15% for more than a decade. Remarkably, some of the larger, billion-dollar Madoff-run funds have never had a down year.

When Barron's asked Madoff Friday how he accomplishes this, he said, "It's a proprietary strategy. I can't go into it in great detail."

Nor were the firms that market Madoff's funds forthcoming when contacted earlier. "It's a private fund. And so our inclination has been not to discuss its returns," says Jeffrey Tucker, partner and co-founder of Fairfield Greenwich, a New York City-based hedge-fund marketer. "Why Barron's would have any interest in this fund I don't know." One of Fairfield Greenwich's most sought-after funds is Fairfield Sentry Limited. Managed by Bernie Madoff, Fairfield Sentry has assets of $3.3 billion.

A Madoff hedge-fund offering memorandums describes his strategy this way: "Typically, a position will consist of the ownership of 30-35 S&P 100 stocks, most correlated to that index, the sale of out-of-the-money calls on the index and the purchase of out-of-the-money puts on the index. The sale of the calls is designed to increase the rate of return, while allowing upward movement of the stock portfolio to the strike price of the calls. The puts, funded in large part by the sale of the calls, limit the portfolio's downside."

Among options traders, that's known as the "split-strike conversion" strategy. In layman's terms, it means Madoff invests primarily in the largest stocks in the S&P 100 index -- names like **General Electric, Intel** and **Coca-Cola**. At the same time, he buys and sells options against those stocks. For example, Madoff might purchase shares of GE and sell a call option on a comparable number of shares -- that is, an option to buy the shares at a fixed price at a future date. At the same time, he would buy a put option on the stock, which gives him the right to sell shares at a fixed price at a future date.

The strategy, in effect, creates a boundary on a stock, limiting its upside while at the same time protecting against a sharp decline in the share price. When done correctly, this so-called market-neutral strategy produces positive

returns no matter which way the market goes.

Using this split-strike conversion strategy, Fairfield Sentry Limited has had only four down months since inception in 1989. In 1990, Fairfield Sentry was up 27%. In the ensuing decade, it returned no less than 11% in any year, and sometimes as high as 18%. Last year, Fairfield Sentry returned 11.55% and so far in 2001, the fund is up 3.52%.

Those returns have been so consistent that some on the Street have begun speculating that Madoff's market-making operation subsidizes and smooths his hedge-fund returns.

How might Madoff Securities do this? Access to such a huge capital base could allow Madoff to make much larger bets -- with very little risk -- than it could otherwise. It would work like this: Madoff Securities stands in the middle of a tremendous river of orders, which means that its traders have advance knowledge, if only by a few seconds, of what big customers are buying and selling. By hopping on the bandwagon, the market maker could effectively lock in profits. In such a case, throwing a little cash back to the hedge funds would be no big deal.

When Barron's ran that scenario by Madoff, he dismissed it as "ridiculous."

Still, some on Wall Street remain skeptical about how Madoff achieves such stunning double-digit returns using options alone. The recent MAR Hedge report, for example, cited more than a dozen hedge fund professionals, including current and former Madoff traders, who questioned why no one had been able to duplicate Madoff's returns using this strategy. Likewise, three option strategists at major investment banks told Barron's they couldn't understand how Madoff churns out such numbers. Adds a former Madoff investor: "Anybody who's a seasoned hedge- fund investor knows the split-strike conversion is not the whole story. To take it at face value is a bit naïve."

Madoff dismisses such skepticism. "Whoever tried to reverse-engineer \, he didn't do a good job. If he did, these numbers would not be unusual." Curiously, he charges no fees for his money-management services. Nor does he take a cut of the 1.5% fees marketers like Fairfield Greenwich charge investors each year. Why not? "We're perfectly happy to just earn commissions on the trades," he says.

Perhaps so. But consider the sheer scope of the money Madoff would appear to be leaving on the table. A typical hedge fund charges 1% of assets annually, plus 20% of profits. On a $6 billion fund generating 15% annual returns, that adds up to $240 million a year.

The lessons of Long-Term Capital Management's collapse are that investors need, or should want, transparency in their money manager's investment strategy. But Madoff's investors rave about his performance -- even though they don't understand how he does it. "Even knowledgeable people can't really tell you what he's doing," one very satisfied investor told Barron's. "People who have all the trade confirmations and statements still can't define it very well. The only thing I know is that he's often in cash" when volatility levels get extreme. This investor declined to be quoted by name. Why? Because Madoff politely requests that his investors not reveal that he runs their money.

"What Madoff told us was, 'If you invest with me, you must never tell anyone that you're invested with me. It's no one's business what goes on here,'" says an investment manager who took over a pool of assets that included an investment in a Madoff fund. "When he couldn't explain \ how they were up or down in a particular month," he added, "I pulled the money out."

For investors who aren't put off by such secrecy, it should be noted that Fairfield and Kingate Management both market funds managed by Madoff, as does **Tremont Advisers**, a publicly traded hedge-fund advisory firm.

E-mail comments to editors@barrons.com

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Exhibit 26

WSJ 6-15-90

Big Board Accelerated Off-Hours Plan Due to Fear of Competition From Rivals

By CRAIG TORRES and WILLIAM POWER
Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—The New York Stock Exchange's sudden acceleration of its plans for off-hours stock trading was triggered by fears about competing efforts by the rival Nasdaq over-the-counter market and by the Big Board's own members.

Big Board members say the exchange acted in large part in reaction to the National Association of Securities Dealers' impending launch of Nasdaq International on Sept. 1, in which the automated quotations system will begin trading 400 to 500 stocks—including some Big Board issues—after hours.

And yesterday, the American Stock Exchange, in a long-expected move, announced that it would "within days" disclose a major joint venture for trading stocks and options around the clock. Meanhwile, other electronic trading networks are expected to unveil trading systems that will offer low-cost executions for big institutional investors away from the Big Board.

In an effort to bring night-time and off-exchange trading back to New York, the Big Board said it plans to start after-hours trading of large baskets of stock later this year; and it plans to start thrice nightly electronic auctions of individual Big Board stocks in 1991.

The Big Board has been mulling after-hours trading for at least two years.

But the Big Board's stepped-up initiatives for after-hours trading may be too late to slow erosion of its share of trading in its own stocks, Wall Street trading executives and large investors say.

While the move to cross baskets of stock after the close was praised by trading executives, big investors said it isn't clear whether the Big Board can pull customers away from systems that are already up and running.

According to one securities executive briefed by the Big Board, the exchange is panicky about the growth in off-exchange trading by brokerage firms who are Big Board members. It wants to effectively force these members to stop their off-exchange activity.

But to do this, the Big Board will have to sacrifice the role of its specialists, the influential traders who have a monopoly to make markets in individual stocks on the exchange floor.

Big Board officials "are saying: 'We will provide an electronic network at low cost because we will ultimately eliminate the intermediary, the specialist,' " said the securities executive. "But part of the deal is they will prohibit off-exchange trading. The risk that the exchange has been running is that one of the major firms decides to exit the exchange."

Right now, the real threat to the Big Board's market share isn't foreign exchanges, but aggressive off-exchange traders such as **Bernard L. Madoff Investment Securities**; electronic trading systems such as Instinet (an electronic order matching systems owned by **Reuters Holdings PLC**); and portfolio trading systems such as Posit and The Crossing Network. All offer cheap, anonymous trading to investors looking to cut trading costs.

Also, there are a host of feisty regional exchanges. And finally, many of the nation's largest banks are having serious discussions about trading among themselves. "Everyone is looking to create alternatives to the New York Stock Exchange," said a senior executive at one of the country's largest banks.

The news about the Big Board's efforts prompted a variety of announcemments about similar efforts from competing exchanges. The Chicago Board Options Exchange said in "the near future" it will announce a major after-hours trading effort. Leo Melamed, head of the Chicago Mercantile Exchange, said the Merc will have its Globex system running by November.

Meanwhile, the Big Board's overall market share continues to slowly erode. In the first four months of this year, the Big Board share of trades in its own stocks averaged 67.8%, compared with 69.7% in the first four months of last year. The market share of the off-exchange third market expanded to an average of 7.4% of overall trading in Big Board stocks for the first four months, compared with 3.1% in the same period last year."

"They had too much shrinkage in market share to sit still," said Junius Peake, chairman of the Peake/Ryerson Consulting Group Inc. "I think they are worried about the Midwest stock exchange," and other competitors, he said.

Exhibit 27

BUSINESS / FINANCE

International Herald Tribune, Thursday, April 15, 1993

Stock Exchanges Get a Shot at New Foe

By David A. Vise
Washington Post Service

WASHINGTON — Who is Bernie Madoff, and why is he driving the Wall Street establishment crazy?

People in the investment business are talking about Bernie over lunch, at conferences, at cocktail parties and on trading floors. They speak of him with the blend of envy and admiration typically reserved for one who pockets millions while others only watch.

But leaders of the New York and American stock exchanges are furious with him and will get a chance to vent their anger this week when they keep an engagement on Capitol Hill to discuss the future of U.S. financial markets.

Bernie runs an investment firm on Third Avenue in Manhattan called Bernard L. Madoff Investment Securities. What makes him a target of wrath is that he has figured out a way, using high-speed computers and telephones and cash, to make big money by taking trading business away from the floors of the New York and American exchanges.

When the Securities and Exchange Commission requested comments on its "Market 2000" stock market study, the letters from the exchanges were filled not only with technical jargon, but also with attacks on competitors, especially Bernie Madoff.

Whether Mr. Madoff, 54, is a smart entrepreneur or the enemy of the small investor and market integrity depends on whom you ask. There is general agreement, however, on what he does.

Using the latest in computer and telephone technology and his firm's $100 million, Madoff "makes markets" — that is, offers to buy stocks when brokerage firms want to sell and to sell when brokerage firms want to buy. He trades as many as 5,000 shares at a time.

His firm, which makes a small profit on the difference in the buy and sell price on each trade, deals in hundreds of stocks listed on the New York Stock Exchange. Thus far, he has managed to garner an estimated 10 percent of the daily transactions that the NYSE handles.

Mr. Madoff has figured out a way to make big money by taking business away from the New York and American exchanges.

Why do brokerage firms trade with Mr. Madoff's firm, rather than taking their individual customer orders to the floor of the exchange? The answer is that he pays the brokerage firms a penny a share to route their customer orders through his system.

It's that payment that provides the ammunition for the attacks on Mr. Madoff; payment for orders is a focus of both the SEC's examination of markets and of the hearing by a House subcommittee headed by Representative Edward J. Markey, a Massachusetts Democrat.

Mr. Madoff's operations raise some important questions for Washington officials who oversee the markets. Are brokerage firm customers, especially individual investors, getting the best possible price on their stock trades? Or are brokerage firms profiting at the expense of their customers by routing their orders to Mr. Madoff and still smaller firms like his?

Mr. Madoff said this week that paying for orders was necessary to compete with the New York exchange because of its strong control of stock trading. He said the money he paid to brokerage firms often was passed along to individual investors in the form of lower commissions.

"I just don't see how anybody can make an argument against the advantages of competition," Mr. Madoff said.

The NYSE's letter to the SEC on the future of markets takes a jab at Mr. Madoff, mentioning in a footnote that another exchange had referred to such payments for orders as "bribes." The exchange said the practice prevented discovery of the best price for stocks by routing orders electronically instead of having them exposed to the auction process on the exchange floor.

"People would like to apply pejorative-type terms," Mr. Madoff said. "I think people that use that kind of terminology are unhappy they are losing business."

■ **Rule Changes Are Urged**

William Donaldson, chairman of the New York Stock Exchange, called Wednesday for repeal of a rule that allows brokers to trade against their own customers' orders, as practice known as internalization, Bloomberg Business News reported from Washington.

The rule allows dealers to trade against their own customers' orders in stocks listed after 1979.

Mr. Donaldson also said regulators should ban a practice known as payment for order flow, in which brokers sell their customer orders to dealers for cash. His comments came in written testimony prepared for the House subcommittee on telecommunications and finance.